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12 July 2018

To whom it may concern

Productivity Commission Issues Paper: Draft Report on Superannuation: Assessing Competitiveness and Efficiency

We are committed to positively contributing to the superannuation industry by supporting initiatives such as the important work you are doing to strengthen this industry and the future prosperity of our country more broadly as a result.

We commend the Productivity Commission Draft Report for a sound and evidenced based report which clearly establishes the following:

- An assessment of what matters most to individuals' retirement outcomes, namely long term investment performance and fees
- The identification of the two major problems existing in the superannuation industry being:
 - Underperforming funds
 - The large number of unintended multiple accounts and associated insurance covers
- The quantification of the losses to an individuals' retirement savings resulting from these problems
- The proposed solutions to overcome these problems and improve the efficiency of the superannuation industry going forward.

The proposed recommendations

PwC supports all of the key recommendations made by the Productivity Commission to address these problems, which we believe will improve the superannuation industry as a whole and lead to better future retirement outcomes for individuals.

Specifically, these recommendations cover:

- Once only default
- Selection of Best in Show shortlist of MySuper funds
- Elevated MySuper authorisation

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- Improved governance of Trustee Boards and oversight of their business operations
- Cleaning up existing lost accounts
- Member friendly and on-line dashboards for all funds (MySuper and Choice)
- Improved regulation around exit fees and disclosure of trailing commissions
- Insurance changes
- Improved clarity of roles of respective regulators.

We also agree that:

- A default retirement product ('MyRetirement') is not warranted
- A government-owned fund is not warranted.

We note that there are risks and concerns for some of these recommendations, such as the selection of the Best in Show shortlist, which may need to be further addressed.

Comments on specific recommendations

We have further comments on the following issues/recommendations:

- Orderly rationalisation/consolidation of the superannuation industry
- Once only default
- Selection of Best in Show shortlist of MySuper funds
- Improved clarity of roles of respective regulators.

Apart from your request for feedback on the roles of respective regulators, we feel that your specific requests for further information are more relevant for industry associations and/or superannuation funds themselves to respond to.

Orderly rationalisation/consolidation of the superannuation industry

With over 100 MySuper funds, over 200 Superannuation funds and 40,000 choice products, we believe that there is an opportunity for significant rationalisation.

Many of the recommendations are designed to encourage the orderly exit of a number of long-term underperforming superannuation funds.

With any industry rationalisation, there will be pain felt by all industry participants, whether service providers, industry organisations, ratings agencies and even more so, by many of the current superannuation funds themselves where jobs will be lost in consolidation and mergers.

We note how difficult it will be for many superannuation funds, who believe they have been doing the right thing by their members, to actively do themselves out of a job.



However, we feel this industry consolidation needs to occur but note that some or many of these changes may be resisted in order to preserve the status quo, especially by those who are most likely to be adversely impacted.

So when considering any alternate recommendations put forward versus these recommendations, it will be important to continue to assess them solely from a members' point of view.

Recommendations made to facilitate the orderly rationalisation

The key recommendations we believe will facilitate the rationalisation/mergers are the ones set out below.

- Selecting the Best in Show MySuper funds - as this creates a responsibility on trustees to benchmark themselves against these high quality superannuation funds, rather than just the median of 100 MySuper funds (or effectively the 50th best fund).
 - When bench-marking against the median (or 50th best) of 100 MySuper funds, it is much easier for any individual superannuation fund to show a reasonable performance and hence an argument to remain in existence.
 - We think it will be a lot harder to demonstrate why a superannuation fund should remain in existence, when they start benchmarking themselves to the Best in Show MySuper funds.
- The requirement to have the APRA outcomes test independently audited every three years will help lift the standard of trustees when assessing their own outcomes.
- Publishing simple and comparable dashboards across all MySuper funds (and choice funds) on a website will make comparative performance more transparent.
- The reporting of merger activity to APRA and having ASIC investigating why planned mergers do not proceed will place a higher level of accountability on planned merger activity.

The other recommendations which also assist the orderly rationalisation are:

- Improved governance of Trustee Boards in regards to skills and ability to appoint independent directors
- Improved regulation around exit fees
- Permanent CGT relief for mergers
- Review of MySuper authorisation every 5 years.



More needed

Where we feel the recommendations may need to go further are set out below.

- We believe that it is still unclear which of the regulators is ultimately responsible for ensuring that underperforming funds are merged into better performing superannuation funds.
 - APRA has a role with superannuation funds reporting proposed mergers to them but ASIC has a role investigating failed mergers.
 - We feel it needs to be clearer as to which regulator will be responsible for ensuring that underperforming superannuation funds are dealt with in an orderly manner.
- We also feel that the appropriate regulator needs additional powers to not just encourage mergers and assess failures of mergers but to also intervene when necessary to stop a merger where it is clearly not in members interests. For example, one unsustainable underperforming superannuation fund merging with another unsustainable underperforming superannuation fund to create a new unsustainable underperforming superannuation fund involves unacceptable and wasted costs to the members of both these funds.
- Given the considerable vested interests in superannuation funds having to do themselves out of jobs, we feel it would be helpful for the appropriate regulator to also issue guidance to Boards on how best to do these assessments. For example:
 - The Board, not management, needs to control the process, brief the expert advisers, ensure their reports come direct to the Board
 - Guidance on what an independent expert report should and should not cover, for example:
 - There should be at least one report that specifically assesses the merger from the member's perspective **only**. That is, whether a member's long term interests is best met by Fund A, or Fund A merged with Fund B, or the Best in Show MySuper funds. This would include consideration of the costs associated with completing the merger in the short and medium term, weighed against the longer term benefit to members.
 - The report should not cover issues such as future Board positions, executive and staff roles nor the need for any ongoing control over the merged entities operations and nor should it be premised on optimistic and unsubstantiated assumptions about future changes to the cost of key services and or membership growth following merger.
 - In the Appendix we have set out some guidance on what we believe an appropriate independent expert report to the Board should and should not cover.
- It needs to be made clear that incurring costs when undertaking a merger should not, in and of itself, prevent a merger from proceeding when it is clear that the longer term consequences will be better outcomes for members. As such, additional guidance may be required from APRA to clarify that Trustees are able to conclude a merger is in the best interests of members when there are longer term benefits to members to offset the shorter term costs arising from the merger. Consideration should also be given to how best to structure fees in the transferring and receiving funds to ensure the equitable allocation of costs across the membership.



- The requirement to have the APRA outcomes test independently audited every three years could potentially be further enhanced at a later stage, if needed, by including an assessment of the fund with the key dashboard metrics of the Best in Show MySuper funds. In our view, the well operating superannuation funds would do this assessment anyway, as this encourages a greater focus on how they are meeting their members' specific needs given they are not one of the best in show.

Selection of Best in Show MySuper funds

We support this recommendation as we believe that it will provide the following key improvements:

- It provides a very good safety net for any first timer in the workforce who does not select their own fund
- It provides a sound "competition threshold" for all trustees of MySuper products to compare themselves to
- It forces a higher threshold test for advisers. That is, if they are advising individuals to move out of one MySuper into another fund (MySuper or Choice), it makes it more difficult to justify if their preferred superannuation funds is not comparable with the Best in Show super funds and this would help reduce miss-selling risks.
- It means that any improvements in governance, design and oversight of MySuper products should also flow through to the oversight of choice products, which should then result in improvements in those products and better outcomes for all members.

We note the main risks with this recommendation are:

- The need to ensure the appointments to the selection panel are not politicised
- The need to ensure the selection criteria for the Best in Show MySuper funds creates the right behaviours and do not encourage poorer long-term investment outcomes.

Ensuring the integrity of the selection of the panel

You have raised a possible solution to this risk by proposing a group of respected statutory appointees (e.g. Governor RBA, ACCC Commissioner and Commissioner of ATO) be tasked with selecting the expert panel. We agree this approach would remove some of the risk of politicisation of the process and that these types of statutory appointees are suitably expert and independent for this role.

To further improve the appointments to the expert panel:

- The selection criteria for the panel should be transparent and public and outline the specific skills and experience being sought, for example institutional investment, superannuation and consumer needs
- Panellists would need to be free of all conflicts at the time of appointment (i.e. independent from the superannuation funds nominating for Best in Show) but also be prohibited from any future role with a Best in Show MySuper fund for a period of time following selection, such as three to five years.



We also agree with your proposal that the Australian Government Actuary would provide an appropriately highly skilled Secretariat to assist the expert panel.

Selection criteria

There is a need to ensure the selection criteria does not result in adverse behaviours such as a focus on shorter term or "herd" investment performance vs longer term performance.

You have indicated that more will be done on establishing the criteria to ensure that this is the case. We believe that with the appropriate support and high level input from the industry, it will be possible to establish suitable criteria.

This criteria will need to ensure that it is possible for high-performing non-incumbent funds to have the ability to compete for Best in Show.

It is also important that the selection process allow for the regulatory history of a potential Best in Show fund to be considered in addition to the objective and transparent criteria; this will allow, for example, the practices of a Trustee in the management of products across their business, MySuper and choice, to allow the panel to form a view about the quality of the Trustee. This regulatory history may take the form of a statement from the relevant superannuation regulators that there is no reason not to allow the fund compete for Best in Show, but would have to be worked through carefully in practice.

In regards to investment performance, we believe that any assessment needs to take into account both quantitative and qualitative assessments such as:

- Assessing long term investment performance (net of all investment related costs) against their own asset allocation benchmark in order to standardise for asset allocation risk and determine value added
- Assessing annual year by year performance (not just rolling 10 year returns) over the longer term in order to determine whether over- or under-performance has been consistent or due to a limited number of recent and one off good or bad years
- Assessing risk adjusted returns taking into account other investment related risks such as liquidity risks
- Assessing the improvements made to their investment practices over the years to address issues of past under-performance and/or risks.



Once off default option

We note that the harm caused by unintended multiple and lost accounts has to be attacked in two ways: 1) clean up the existing unintended accounts and 2) stop the new unnecessary accounts from being created every time a person changes jobs.

The clean-up of existing lost accounts is dealt with in a separate recommendation for enhanced ATO processes and cessation of Eligible Rollover Funds.

In order to stop the creation of future unintended multiple accounts whenever a person changes jobs, we support the recommendation to 1) only ever default people once into a superannuation fund, which would be on entering the workforce for the first time if they chose to not nominate a superannuation fund and 2) sequentially allocate defaulted members into one of the Best in Show MySuper funds.

In addition, this recommendation:

- Reduces the likelihood of unengaged individuals ending up in underperforming funds (given they would be put in a Best in Show MySuper fund if no choice is made)
- Facilitates increased member engagement, as the online ATO process will make it easier for an individual to easily compare any superannuation fund (whether their existing or any other) with the Best in Show MySuper funds
- Removes employers from being involved in the selection of default superannuation funds for their employees
 - In our experience small employers were never adequately equipped to make this decision and many large employers no longer wish to make this decision
 - We are also aware of larger employers who now believe the relationship should be between a superannuation fund and the individual and who no longer want their brand associated with the performance of a superannuation fund they have no control over.

We note that contrary to some assertions or misunderstandings, the once only default process does not “lock a person” into the default fund for life, as people can change their superannuation fund at any time.

Alternate model of auto balance rollovers of accounts to latest fund

An alternate model has been proposed by some industry representatives where:

- The current employer-determined default superannuation process remains in place
- The only change being that on starting a new job, all previous account balances will automatically transfer to the new employers’ default fund, unless the person elects otherwise.

From a members’ perspective we cannot see how this alternate solution to unintended multiple accounts is a better solution than that proposed for the following reasons:



- This approach would result in multiple transfers of an unengaged individual's superannuation monies through multiple superannuation funds within relatively short periods of time every time they changed jobs:
 - As noted in your report, the largest increase in individuals holding two or more accounts happens between the ages of 18 and 25, consistent with the widely held view that young people continually default as they move through various casual jobs
 - Under this proposal, one person's superannuation would cycle through multiple superannuation funds, which creates unnecessary administration costs for setting up and closing out memberships, transfer costs as well as the impact of constant changes to insurance covers
- How would the new default fund be determined where people have multiple jobs? For example, the latest job may simply be a casual or part time role and therefore the latest job is not the most desirable to determine the new default superannuation fund into which all other superannuation monies should be transferred
- This alternate proposal:
 - Does not remove the employer from determining the default superannuation fund, which must ultimately be the preferred path
 - Does not facilitate member engagement
 - Potentially exacerbates the current unlucky lottery for unengaged members, as now all of their accumulated superannuation monies (not just new contributions) would be placed into the latest employers' default superannuation fund, as compared to a Best in Show MySuper fund.

The key benefit of this arrangement seems to be to preserve the status quo for existing MySuper funds, where unengaged members' superannuation is placed in MySuper funds determined by the employer.

Improved clarity of roles of respective regulators

We believe there needs to be a clear understanding of the respective responsibilities of APRA and ASIC, particularly in the context of resolving underperforming funds and managing fund consolidation.

You have asked whether APRA is best placed to specifically focus on ensuring high standards of system and fund performance, and ASIC to specifically focus on the conduct of trustees and the appropriateness of products (including for particular target markets).

APRA's prudential framework focuses on the conduct of trustees as it relates to the management and oversight of the business operations for the collective interests of members (e.g. the current proposed prudential reforms covering strategic and business planning and regular assessments of member outcomes etc.). ASIC's responsibilities, on the other hand, might be described as being focused more on the trustee's behaviour as it affects individual member outcomes. Seeking to demarcate responsibilities along conduct lines could result in framework gaps being created that could result in negative regulatory outcomes for members.



In addition, we have already noted the confusion over which of the regulators will be responsible for ensuring that underperforming funds are merged into better performing superannuation funds when APRA has a role with superannuation funds reporting proposed mergers to them but ASIC has a role investigating failed mergers.

We suggest that APRA be given primary responsibility over the merger of superannuation funds – consistent with current regulatory responsibilities – and that it be clear that APRA and ASIC will coordinate to take effective regulatory action in the event of a failed merger. This, for example, might be included as a specific area of activity in the APRA-ASIC memorandum of understanding or associated documentation outlining the relationship between the bodies.¹

APRA needs to be held accountable for ensuring that underperforming funds are dealt with in a timely manner, preferably prior to the commencement of the Best in Show process. The process will be more efficient if there are fewer superannuation funds to consider and the ones that are being considered are of a higher quality.

Our view is that clearer communication by both APRA and ASIC as to when they take regulatory action, through media releases or other public communications, will also assist to reduce confusion and serve the necessary deterrent effect that you call out as being somewhat absent.

Conclusion

In conclusion, we continue to encourage your work as we believe it will ultimately improve the efficiency of the system and the outcomes for members and we remain committed to being involved however best we can add value.

We would welcome the opportunity to participate in any further way that would be helpful to you.
Please contact me on _____ or Catherine Nance

Kind regards

Craig Cummins Partner National Superannuation Leader PwC Australia	Catherine Nance Partner PwC Australia
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¹ For example, <https://asic.gov.au/about-asic/what-we-do/our-role/other-regulators-and-organisations/the-apra-asic-relationship/>



Appendix: Independent Expert Report on a potential merger

When considering potential mergers, there is often the need for an independent expert report on whether a possible superannuation fund would be an appropriate merger partner, prior to making any decision to enter into a Memorandum of Understanding after which the detailed due diligence would be undertaken.

We have to recognise the reality that management and to a lesser extent the Board of the superannuation fund, has a considerable vested interest in the continuation of their superannuation fund and/or their roles. Hence we feel it would be helpful for the appropriate regulator to issue some guidance to Boards on how best to do these independent reports in order to ensure members' best interest is the only factor in making this assessment.

In our experience, this guidance may need to cover both the process of obtaining this report and the content of this report.

Process

In our view the Board, not management, needs to be in total control of this process, which includes setting the scope of the report, briefing the expert advisers, liaising with the external advisers and ensuring all draft reports come directly to the Board.

It is reasonable that management are included in the process, as they will be required to supply information and it is important that they input into the decision, but this is a major strategic initiative and the Board needs to control the process.

Content

It is up to the various Boards as to what independent expert reports they obtain but we believe there should be a requirement to obtain at least one report that specifically assesses the merger from the member's perspective **only**. That is, whether a member's long term interests is best met by Fund A, or Fund A merged with Fund B, or the Best in Show MySuper funds

The sole purpose of this report would be to assess whether a member's long term interests is best met by Fund A, or Fund A merged with Fund B, or an aggregate or sample of the Best in Show MySuper funds.

We have set out below a summary of indicative information which should be covered.

Just as importantly, it needs to be clear what the report should not cover and this is also set out below.



What should be covered for Fund A vs Fund B vs Fund A + B, vs aggregate or sample of Best in Show

- Fund statistics
 - Market share (current and recent past)
 - FUM (current and recent past)
 - Members (current and recent past)
 - Relevant membership demographics for example
 - Active members vs inactive
 - Impact of proposed lost account consolidation on membership
 - Account balance metrics
- Cash flow information
 - Net cash flows (current and recent past)
- Strategic direction
 - Key strategic goals
 - Distribution and membership strategies
 - Innovation initiatives
- Governance
 - Composition and skills of Board and committees
- Operating metrics
 - Operating expenses vs cash flow (current and recent past)
 - MER (current and recent past)
 - Costs per member
 - Costs per active member
- Financial resources
 - Reserves
- Key member features
 - Products
 - Online and other servicing options
 - Financial advice and education options
- Investment structure and performance
 - MySuper investment strategy
 - Long term (10 year) and year by year investment performance in MySuper



- Administration
 - Administrator and systems
- Insurance
 - Default and optional covers and premiums
- Fees
 - Administration fee
 - Total Investment fee split by components (investment, indirect and performance)
 - Total PDS member fee for member on \$10,000, \$50,000, \$100,000 etc.
- An assessment of one off and itemised costs (short and medium term) of completing the merger (e.g. staff, premises, administration etc.) and cost savings:
 - This assessment should be based on known costs in the current arrangements.
 - There should be no adjustment made for any unsubstantiated or unconfirmed changes to future operations. For example, assuming that the merged fund could enter into significantly more favourable arrangements re costs of service delivery and/or could have significantly more favourable membership growth.
- Overall value for money assessment for members both in the short and longer term.

What should not be covered

To ensure the assessment is done solely from the point of view of the member, the following issues should not form part of any report:

- Future Board positions
- Future executive and staff roles
- Any assessment of ongoing control over the merged entities and/or operations and/or disruption of operations such as existing contracts for service providers.